MARK SCHEME for the October/November 2006 question paper

9706 ACCOUNTING

9706/04 Paper 4 (Problem Solving (supplement)),
maximum raw mark 120

This mark scheme is published as an aid to teachers and students, to indicate the requirements of the examination. It shows the basis on which Examiners were instructed to award marks. It does not indicate the details of the discussions that took place at an Examiners’ meeting before marking began.

All Examiners are instructed that alternative correct answers and unexpected approaches in candidates’ scripts must be given marks that fairly reflect the relevant knowledge and skills demonstrated.

Mark schemes must be read in conjunction with the question papers and the report on the examination.

The grade thresholds for various grades are published in the report on the examination for most IGCSE, GCE Advanced Level and Advanced Subsidiary Level syllabuses.

- CIE will not enter into discussions or correspondence in connection with these mark schemes.

CIE is publishing the mark schemes for the October/November 2006 question papers for most IGCSE, GCE Advanced Level and Advanced Subsidiary Level syllabuses and some Ordinary Level syllabuses.
QUESTION 1

(a) Capital reconstruction account

Goodwill  110 000 (1)  Preference share capital  100 000 (1)
Profit & loss account  410 000 (1)  Ordinary share capital  375 000 (1)
Stock  4 000 (1)  Freehold land  45 000 (1)
Bad debt  21 000 (1)  Investments  25 000 (1)

545 000  545 000  [8]

(b) Balance sheet at 30 April 2006

$000  $000

Fixed assets
Premises  260 (1)
Vehicles  60 (1)

320

Current assets
Stock  36 (1)
Debtors  35 (1)
Bank  160 (1)
Cash  4 (1)

235

Creditors  80 (1)  155

475

Share capital and reserves
Ordinary shares of $0.25 each (1)  (1) 149 (500 (1) − 375 (1) + 24 (1) )
Preference shares of $0.50 each (1)  (1) 100 (200 (1) − 00 (1) )
Share premium  (1) 226 (250 − 24 (1 of) )

475 (1 of)

Authorised share capital
1 000 000 ordinary shares of $0.25 each  $250 000
500 000 8% preference shares of $0.50 each  $250 000  [20]
(c) (i) $0.68 \(\times\) 340 000 (2)  
500 000 (1)  
(1) for $ sign in both answers

(ii) $0.63 \(\times\) 375 000 (2)  
596 000 (1)  
[9]

(d) Share holders not disadvantaged \(0 – 3\)

Creditors not disadvantaged \(0 – 3\)

Business will be profitable after the reconstruction \(0 – 3\)

1 mark for identification a further two marks for development.  
[3]
Question 2

(a)  

\[
\begin{array}{ccc}
\text{Sq} & \times & \text{Sp} \\
18000 & 4 & = 72000 \\
\text{Aq} & \times & \text{Sp} \\
17840 & 4 & = 71360 \\
\text{Aq} & \times & \text{Ap} \\
17840 & 4.10 & = 73144 \\
\end{array}
\]

- 640 favourable material usage (2)
- (1784) adverse material price (2)
- (1144) adverse total material variance (2)  [6]

(b)  

\[
\begin{array}{ccc}
36000 & \times & 7 = 252000 \\
36300 & \times & 7 = 254100 \\
36300 & \times & 7.25 = 263175 \\
\end{array}
\]

- (2100) adverse labour efficiency (2)
- (9075) adverse wage rate (2)
- (11175) adverse total labour variance (2)  [6]

(c)  

\[
\begin{array}{ccc}
27000 & \times & 8 = 216000 \\
27400 & \times & 8 = 219200 \\
27400 & \times & 7.9 = 216460 \\
\end{array}
\]

- (3200) adverse labour efficiency
- 2740 favourable wage rate
- (460) adverse total labour variance (2)  [6]

(d)  

2 marks for each reason why the variances have arisen

- (i) use of better quality materials
- (ii) use of better quality materials costing more
- (iii) less skilful labour being used
- (iv) pay rise awarded to workers
- (v) less skilful workers being used
- (vi) lower grade workers being used

1 mark for identification plus one mark for development.  [12]
(e) More expensive, better quality materials being used which have cost more than expected (machining). Employment of unskilled workers at a time when unions have negotiated a pay rise (machining). Employment of lower skilled workers who are paid at a lower wage rate than anticipated (finishing).

1 mark for identifying the interrelationship, two further marks for a clear explanation how the interrelationship occurs. [6]

(f) Makes budgets easier to prepare (0 – 2)
Makes budgets more realistic (0 – 2)
Differences between actual expenditure and budgeted expenditure is easy to identify (0 – 2)
Essential for responsibility accounting (0 – 2)
Can help in calculating costs for quotations and orders (0 – 2) etc. [4]
### QUESTION 3

(a) Trading, Profit and Loss and Appropriation Account for the year ended 30 September 2006

<table>
<thead>
<tr>
<th>$000</th>
<th>$000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>1626</td>
</tr>
<tr>
<td>Cost of sales</td>
<td>819</td>
</tr>
<tr>
<td>Gross profit</td>
<td>807 (1)</td>
</tr>
<tr>
<td>Operating expenses</td>
<td>672</td>
</tr>
<tr>
<td>Operating profit</td>
<td>135 (1 of)</td>
</tr>
<tr>
<td>Interest paid</td>
<td>12 (1)</td>
</tr>
<tr>
<td>Profit before tax</td>
<td>123 (1 of)</td>
</tr>
<tr>
<td>Taxation</td>
<td>28 (1)</td>
</tr>
<tr>
<td>Profit after tax</td>
<td>95 (1 of)</td>
</tr>
<tr>
<td>Preference dividend paid</td>
<td>5 (1)</td>
</tr>
<tr>
<td>Proposed dividends preference</td>
<td>5 (1)</td>
</tr>
<tr>
<td>Ordinary</td>
<td>35 (1)</td>
</tr>
<tr>
<td>Retained profit for the year</td>
<td>50 (1 of)</td>
</tr>
<tr>
<td>Balance brought forward</td>
<td>130</td>
</tr>
<tr>
<td>Balance carried forward</td>
<td>180</td>
</tr>
</tbody>
</table>

(b)  

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest cover</td>
<td>11.25 times (1) of</td>
<td>10 times (1) of</td>
</tr>
<tr>
<td>EPS</td>
<td>$0.14 or 14.17 c (1) of</td>
<td>$0.12 or 12.17 c (1) of</td>
</tr>
<tr>
<td>P/E ratio</td>
<td>11.29 (1) of</td>
<td>11.09 (1) of</td>
</tr>
<tr>
<td>Dividend yield</td>
<td>3.64% (1) of</td>
<td>2.47% (1) of</td>
</tr>
<tr>
<td>Dividend cover</td>
<td>2.43 times (1) of</td>
<td>3.65 times (1) of</td>
</tr>
</tbody>
</table>
(c) Interest cover shows how many times interest payments are covered by operating profits. Cover has improved (1) and interest charges are still comfortably covered (1) increased by 1.2 times (1).

Earnings per share shows how much profit (after interest, tax and preference dividends) is attributable to each ordinary share. The ratio is used as a convenient measure of success.

The ratio has improved (1) by 2 cents in the second year (1 of).

Price earnings ratio relates the market price of a share to its earnings. There has been a slight improvement (1) indicating greater confidence of Investors in the company (1).

Dividend yield expresses the dividend as a percentage of the market price of a share. This will indicate to investors how much they can expect as a return on each $ invested.

There has been an improvement (1) of about 50% (1 of) over the year.

Dividend cover shows how many times the ordinary dividend can be paid out of profits after interest, tax and preference dividends. There has been a deterioration (1) of about 1/3 this year which might indicate that future dividends might be at risk (1).

Maximum of 2 marks for each ratio

(d) Share capital and reserves $000

<table>
<thead>
<tr>
<th>Share capital and reserves</th>
<th>$000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ordinary shares of $0.50 each</td>
<td>450 (300 (1) + 150 (1) )</td>
</tr>
<tr>
<td>Revaluation reserve</td>
<td>140 (290 (1) – 150 (1) )</td>
</tr>
<tr>
<td>Capital redemption reserve</td>
<td>100 (2)</td>
</tr>
<tr>
<td>Profit and Loss account</td>
<td>70 (180 (1) – 100 (1) – 10 (1) )</td>
</tr>
</tbody>
</table>

760 (1 of)